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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE commonly used measures of business activity continue to indicate the existence of some slack in various branches of production and distribution. Iron and steel and automobile manufacturing are substantially lower than at this time a year ago, and trade generally presents a more uneven appearance than was the case in August last year when a recovery was well under way from a period of hesitation in the Spring and early Summer.

At the same time it is clear that business in the aggregate continues in very large volume. While factory employment and payrolls and railway traffic have shown some reduction, several leading lines of trade such as textiles, leather tanning, and shoe manufacturing reflect large or expanding activity, and industrial consumption of electric power and bank checks cashed throughout the country are running about the same as or slightly higher than a year ago. Definite indication as to the trend of Autumn business is still lacking, but the absence of any fundamentally unfavorable factors affords ground for confidence.

Unquestionably one principal cause of irregularity is the diminished activity in the automobile industry, caused chiefly by the shutdown of the Ford plants which have been undergoing extensive changes preparatory to the manufacture of new models. This industry has become so important a factor in our economic life by reason of its large employment of labor and consumption of materials of all sorts that any change in its manufacturing schedules is quickly felt over a wide area. For this reason account should be taken of the fact that the present relatively low production in that industry is due partly to temporary causes and may be counterbalanced by increased production later on.

Besides decreased activity in automobile manufacturing, business has had to contend with rainy and unfavorable weather for trade in many sections, the soft coal strike, overproduction in oil, and the effects of floods. In addition there is a natural tendency for a breathing spell to follow periods of high level operations like the past year. All things considered, it is not surprising that business should present a somewhat unsettled aspect, and under the circumstances the cheerful attitude generally preserved is reassuring.

The Agricultural Outlook

The crops have deteriorated somewhat in the past month, but still promise a larger aggregate return to producers than was realized last year. The Spring wheat crop in Minnesota and the Dakotas has been hurt by rust, and is not as uniformly good as was promised in July, nevertheless the yield is believed to be better than for several years. The crop in the Pacific northwest is excellent. In the mountain states of the West and the belt from Canada to Mexico which includes the Dakotas, Nebraska, Kansas, Oklahoma and Texas conditions generally are very good. In the States named the corn crop will be larger than last year, but these are almost the only States in which this is the case. The Government's report for all wheat, based on conditions August 1, indicates 851,000,000 bushels, against 833,000,000 last year, but there may be some shrinkage from this. The other grain crops are as good as or better than last year, excepting corn, which has done poorly in August and cannot make an average crop. It is the worst spot in the middlewest situation this year. The hay crop is excellent and the country abounds in forage for live stock. The cattle industry is prosperous, and the dairy industry is doing well. Hog producers are hurt by the poor outlook for corn.

The Government's August report upon cotton, indicating 13,492,000 bales, was surprisingly unfavorable, but opinion generally in the South has accepted it as well-founded. The weevil is more of a menace than it has been for several years. The effect of the outlook has been to raise the price above 23 cents, at which figure a 13,000,000 bale crop would bring more money to producers than last year's crop did.

Easy Credit Conditions

A factor of outstanding importance is the continued ease of money, which has been accentuated by action of the Federal Reserve banks in reducing rediscount rates and in making credit more readily available by their purchases of Government securities. While the ultimate consequences of continued easy money are by no means always favorable, the immediate influence is bullish, and any substantial trade recession under present conditions would be contrary to experience.

In short, business continues to have the benefit of much the same conditions that have been supporting it to this time. Building continues at high levels. Inventories are low, money is easy, and commodity prices are low in comparison with the purchasing power of wages. While wages are high the net cost of labor is reduced by the high per capita output which has been made possible by the use of labor-saving devices. Industry and transportation continue to function efficiently, and waste is being steadily reduced. These conditions, including the state of the long term money market, are favorable to the inauguration of large scale investment enterprises, and the current record of construction contracts shows a trend to operations of this kind. Hydro and steam electric power plants, bridges, industrial expansion and reconstruction are calling for large expenditures, all meaning employment for labor at good wages. The fact is that the state of the money markets is more suggestive of expanding than of declining activities, and although there is danger that cheap money may promote undue competition for existing securities, it affords the fundamental condition for a great period of healthful industrial progress.

The Trend of Industrial Profits

In the August number of this Review comment was made upon the favorable showing of corporation earning statements for the second quarter published and available at the time of our going to press. Since then additional statements have come out which have failed to measure up fully to the standard of the earlier reports. As a result, out of a total of 168 leading companies whose figures have thus far been tabulated, 90 companies or 54 per cent, now show smaller earnings than were made a year ago, while the combined earnings for all companies likewise fell slightly below those of the second quarter of last year, even with the inclusion of the large gain for the General Motors Corporation. Without the latter's figures there was a decrease of about 14 per cent.

Bearing also on the question of earnings, though from another angle, are the business failure figures which have been continuing their tendency to increase. For the first seven months of this year, according to R. G. Dun & Co., the increase in number has amounted to 7.4 per cent and in liabilities 35.5 per cent as compared with the corresponding period of 1926. Following is a table giving the comparative figures by quarters and for the month of July in both years which reveals this upward trend:

	Number		Liabilities (In thousand dollars)		Per Cent Increase	
	1926	1927	1926	1927	Number	Liabilities
1st quarter	6,081	6,643	108,460	156,122	9.2	43.9
2nd quarter	5,395	5,653	101,438	125,406	4.8	23.6
July	1,605	1,756	29,680	43,150	9.4	45.3
Total 1st 7 months	13,081	14,052	239,578	324,678	7.4	35.5

That business is encountering more strenuous competition and that the ill equipped and less efficiently managed companies are falling more rapidly by the wayside seems to be clearly shown by these figures. At the same time it is apparent that there is nothing in the present statistics to occasion alarm over the ability of well managed concerns to make at least an average good showing. Measured by any other standard than that of 1926, which was an unusually good year, and taking industry as a whole, present profits are by no means unsatisfactory, and in most cases amply provide for dividend requirements and generous additions to reserves. The fact that a decrease has occurred is significant and will bear watching, but unless the decline goes considerably farther than it has up to now, it need not be regarded as significant of any fundamental change.

Railroad Earnings Lower

Accompanying somewhat lower profits by industrial companies, railway earnings have been running below those of a year ago. For the month of June net earnings of Class 1 roads totalling $87,363,547, showed a loss of 18.6 per cent from those of June a year ago, and the reports thus far available for July show a loss of somewhat over 26 per cent from July last year. In only two months this year, to wit, February and March, have the net earnings been as good as in the corresponding months of last year, and for the first six months the total shows a decline of 4.6 per cent.

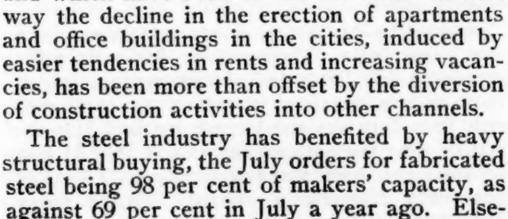
Explanation for the shrinkage sustained thus far this year lies both in smaller gross receipts and in increased expenditures. Due to a large decrease in gross for June resulting from a falling off in freight traffic and decline in passenger revenues, total gross earnings for the first six months fell slightly below those of a year ago. Meantime taxes increased $1,526,000, and operating expenses $4,436,000, all of the latter, and somewhat more, representing wage advances granted during the year. Notwithstanding that the roads

employed fewer workers this year than last, the effect of this economy was more than offset by the increase in the wages paid per man.

Measured in terms of rate of return on property investment, as calculated by the roads themselves, the figures work out to an annual rate of 4.58 per cent, as compared with 4.93 per cent in the first six months of 1926. Considered on the basis of the Interstate Commerce Commission's lower tentative valuation, they work out to an annual rate of 5.6 per cent, as compared with 5¾ per cent named by the Commission as a fair return which the railroads should be entitled to earn as a minimum. What the rest of the year holds forth in the way of earnings remains to be seen. August, with car loadings running below those of a year ago, is expected to show little if any improvement. In the Northwest, however, the earnings should ultimately reflect the better crop conditions of that section, while in the South losses in traffic due to a smaller cotton movement may be offset by larger incoming traffic resulting from higher prices and increasing purchasing power.

Building and the Steel Industry

While it is true that building permits have been running for months below the figures of last year, the statistics of contracts actually awarded, as reported by the F. W. Dodge Corporation, which are a better measure of total building volume at this time, have consistently equalled or exceeded the figures of a year ago. Explanation of the different movement of the two indexes, illustrated in the accompanying diagram, lies chiefly in the fact that the contract figures include a large amount of engineering work such as building of roads, subways, bridges, etc., not covered in the permits



and which have been on the increase. In this way the decline in the erection of apartments and office buildings in the cities, induced by easier tendencies in rents and increasing vacancies, has been more than offset by the diversion of construction activities into other channels.

The steel industry has benefited by heavy structural buying, the July orders for fabricated steel being 98 per cent of makers' capacity, as against 69 per cent in July a year ago. Elsewhere in the industry, however, buying is slack, and although prices have held, mill operations have not shown the improvement hoped for in August.

The Situation in Automobiles

While a number of influences have contributed to the lag in the steel industry,—notably the failure of the railroads to increase their purchases and the lack of demand from the oil business,—one of the main reasons for the slow steel market is the situation in the automobile industry. Production of automobiles in July totaling 263,406 passenger cars and trucks was at low ebb for the year, and the smallest for any July since the 1924 slump. As compared with July a year ago passenger car output was off 26 per cent, and truck output 20 per cent. While August witnessed a considerable pick-up in operations as compared with the Summer low point, the weekly employment figures at Detroit indicate that the production figures for the month will fall considerably below those of August last year.

Low figures for the automobile industry as a whole are by no means typical of all companies, but are due mainly to the inactivity of the Ford plants. General Motors production and sales in July, for example, were the largest ever reported for the month, and most of the other leading manufacturers have also been doing a large business. Total output, however, for all companies for the first seven months of the year fell 13 per cent below that of the same period of last year, indicating that the industry as a whole fell some 370,000 cars short of making up the loss sustained by Ford.

August is frequently the month of peak activity for the second half year in the industry, whence production generally tapers off to the year-end, but this year the expected expansion of Ford operations introduces a factor which may materially improve upon the showing thus far made by the industry as compared with a year ago. The fact that the new Ford car has attracted such widespread interest throughout the country justifies the supposition that there are a great many people who have been intending to buy cars but have delayed taking action in order to see what the new product would look like, and who may come into the market as active purchasers for it or other makes. Certain it is that developments in the industry will be watched with great interest by business generally, and that a stiff battle for the low priced field is in prospect, from which the automobile buyer is sure to benefit.

The Non-Ferrous Metals

Reduction in prices of the three principal non-ferrous metals was put into effect the latter part of August by leading producers and buying at the present time is reported to be unusually light. The situation is regarded in the nature of a reaction from the spurt of ac-

tivity that took place recently, starting the middle of July and lasting through the first week of August, during which time heavy buying occurred and prices of copper, lead, and zinc each gained approximately one-half cent a pound. Since then the falling off in new business has brought about slight price reductions so that present quotations are down, on an average, about one-quarter cent from the recent high and have lost half of their advance.

Outlook is regarded as satisfactory and it is generally believed that the full year 1927 should show a volume of sales and earnings for concerns in the metal trade that will compare favorably with last year. Prices of nonferrous metals have all ruled slightly below 1926, which will affect profits of mining companies more than those of commission smelters and refiners, dealers, and importers, and fabricators.

Production of copper (refined) in this country for the first seven months of the current year was about 6.5 per cent larger than for the corresponding period last year and domestic consumption, on which exact statistics are not available, is understood to have run slightly lower. However, this has been offset by an improvement in the export movement which for the half year showed a tonnage gain of 13 per cent, the takings of Germany, now our principal customer, increasing from approximately 57,000,000 pounds to 120,000,000, while shipments to France decreased from 105,000,000 pounds to 45,500,000. The combined domestic and foreign demand therefore has been so well sustained that stocks of refined and blister copper on hand show only a slight increase as compared with a year ago. Of the two chief uses of copper in this country, building apart from engineering work has been slowing down somewhat while automobile manufacture, as described in previous paragraphs, has receded more than usual during the Summer but is looking forward to a better Fall season.

The largest use of lead is in storage batteries, the manufacture of which has decreased somewhat this year although it is difficult to say how much; the second largest use being cable coverings and third as white lead. Regardless of new construction, the normal installation and replacement of cables, and repainting buildings with lead (outside) paint for preservation results in a very stable demand for this metal. Even in the depression of 1920-21 the consumption of lead did not decline nearly so much as did that of copper and zinc. While buying is not particularly heavy compared with last year, if one looks back a few years previous the present figures stand very well in comparison.

The zinc market is quiet. Production as given in the statistics for the first seven months is practically the same as last year, while total deliveries show a decline of 1.8 per cent, so that stocks at smelters are heavier but still represent less than one month's output. Principal use of zinc is in "galvanizing" steel, either by dipping or electrolysis, in the manufacture of sheets and other shapes. Sheet mill operations this year have been quite stable, without declining so much during the Summer as did most other branches of the steel industry. Zinc has many other uses, as in brass goods (alloyed with copper), paints (zinc oxide), and in numerous chemical and medicinal compounds. There seems to be a disposition among zinc producers to follow a "live and let live" policy, contrasting with the overproduction and cut-throat competition witnessed a few years ago, and latest reports indicate that operations are being pruned down to correspond closely with actual deliveries to consumers, who usually purchase only for immediate requirements and not weeks ahead as was the practice formerly.

Continued Activity in Textiles

In the textile industry the cotton goods trade received a shock in the Government's unexpectedly low estimate of the cotton crop, but after the first period of hesitation made a strong response to the new figures. Buying has been very active, and some of the leading commission houses have reported a large volume of business at advanced prices.

Following is a table from the Journal of Commerce giving comparative prices of standard cloths as of August 30, August 1, and a year ago, which indicates the extent of the advances that have taken place:

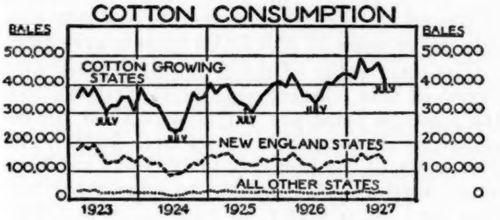
COTTON GOODS QUOTATIONS

	Aug. 30 1927	Aug. 1 1927	Aug. 30 1926
Cot. mid. up. spot, N. Y....	22.50	18.25	19.05
Print cloths, 28-in., 64x64s	6⅞	6¼	5⅝
Print cloths, 28-in., 64x60s	6⅝	6	5⅝
Print cloths, 27-in., 64x60s	6⅜	5¾	5⅛
Gray g'ds, 38½-in., 64x64s	9½	8¼	8
Gray goods, 39-in., 68x72s	10	9⅛	8½
Gray goods, 39-in., 80x80s	11¾	10½	10½
Brown sheetings, 3-yard..	13	11¼	11¾
Brown sh'tgs, 4-yd., 56x60	11¼	9¾	10
Brown sheetings, stand....	14	12¼	12¼
Tickings, 8-oz....................	22½a23	19½a21	19½a20
Denims	18½	16	15½
Staple ginghams, 27-in....	9½	9½	9
Kid finished cambrics....	8½a 9½	8 a 9	8½a 9
Dress ginghams	14⅝a16½	14⅝a16½	12½a16½
Standard prints	8½	8	8

Production of cotton goods continues on a very large scale. During July domestic mills consumed 569,250 bales of raw cotton, which represents a seasonal decrease as compared with June but was the largest for any July on record. For the cotton year closed July 31 last the total consumption amounting to 7,202,724 bales was likewise a record, 746,872 bales above the total the previous year.

That this business, however, was very unequally distributed is shown by the diagram

below, which compares the mill consumption by districts and indicates the manner in which the industry in the South has been forging ahead of that in other sections. It is a striking fact that of the increase in consumption reported last year only 59,388 bales occurred in the New England States as against 693,917 bales for the cotton-growing States.



With the output of cotton goods running at record breaking levels, and with the mills generally well covered on cotton bought at much lower price levels, the present prices afford a margin of profit to spinners which should be reflected in a marked improvement in earnings for the current year.

In other textile lines a feature of the month has been the further moderate improvement in woolens. Certainly nothing in the nature of a boom has taken place, but a better sentiment is noted all around, and considerable real activity is reported to have developed in some lines of Fall women's wear. Prices of raw wool are continuing firm, consumption is showing a good gain over last year, and stocks are below average. One cause of the better feeling in the trade is the firm stand taken by the American Woolen Company in pricing its Spring 1928 lines, the moderate advances named reflecting the rising trend of wool values and the increased cost of weaving due to the present-day variety of styles.

The silk trade, on the other hand, has been unsettled by the persistent weakness of raw silk which has its inception in stringent credit conditions in Japan following the banking panic this Spring. Recently, however, prices have shown a firmer trend which the trade is hoping will prove to have marked the bottom.

Improvement in Leather and Shoes

The spectacular advance in hide prices which has been in progress since March received a rather sharp setback in late July and in August when prices of packer hides reacted 3½ cents a pound to 20 cents. The decline came as a surprise to no one, as it was generally felt that the advance had been too rapid. Present quotations, barring only July, are still the highest since 1920, and with stocks of hides and skins generally short of demand all over the world, there is no doubt as to the underlying strength of the market.

Accompanying higher hide prices, leather values are rising and tanners are expanding operations. The boot and shoe industry which consumes approximately 80 per cent of the output of the tanneries is experiencing a decided improvement in business, and prices are marked for advances in keeping with higher raw materials. Many factories in New England that have been operating on a part-time basis have returned to full operation, and in localities where part-time is continuing the forces employed have been increased. With increased production and a firmer trend of prices, outlook for considerably better earnings in both the tanning and shoe industries is bright.

The Coal Strike

With the soft coal strike now entering its sixth month and the season of gradually increasing consumption at hand, the question of the coal supply which has heretofore lain in the background is becoming a more pressing one.

When the strike started on April 1 consumers' stocks of bituminous coal on hand were estimated by the Government at 75,000,000 tons, the largest on record. Until recently production has averaged 8 to 8½ million tons weekly, or about a million tons weekly less than estimated consumption. By July 1 stocks were estimated as down to 62,000,000 tons (also a record for that date), and since then a further reduction has occurred. That the public has deliberately chosen to supply much of its current needs from the stock piles rather than from current production is shown by the fact that at no time has demand taxed the capacity of the non-union mines which could easily have expanded their production had there been any call for it.

The National Association of Purchasing Agents in a statement issued during the month warns industry against too complacent an attitude towards the strike. While disclaiming any desire to be an alarmist, the Association points out substantially the facts listed above, namely that reserve stocks are being reduced at a time when the season of heaviest consumption is approaching, that the duration and scope of the strike is uncertain, and that it would be the part of wisdom to purchase for current needs while ample supplies are available and save reserve supplies for a possible emergency.

Similarly, the Railway Age states editorially that if consumers continue to deplete their stocks by buying less than can be easily produced they may enter the Fall months with no more than normal supplies, which, if the strike continues, may not be enough to satisfy the increased demand.

Signs that the public is beginning to feel some uneasiness over the situation are multiplying. Buying is picking up and prices,

which have been weak most of the Summer, are showing a firmer trend. The Coal Age weighted price average advanced 10 cents in the latter part of August, at which level it stands considerably above mid-summer levels, and about the same as at the commencement of the strike, as indicated by the following table giving the figures for recent weeks and for the first week in each month since the beginning of the year:

First week of:	Price per Ton at Mines
January	$2.33
February	2.16
March	2.06
April	2.09
May	1.91
June	1.85
July	1.83
First week in August	1.98
Second week in August	1.99
Third week in August	2.05
Fourth week in August	2.10

Responding to a better demand, production is also increasing, the total for the week of August 13 rising above 9,000,000 tons for the first time since the strike, with a further increase to 9,142,000 reported for the week of the 20th. The following table comparing the weekly production figures of this year and a year ago shows the trend of output since the strike. In comparing the figures with last year it should be remembered that a factor in the heavy production of last Summer and Fall was the increased export demand resulting from the British coal strike.

Week ending	1927 (tons)	1926 (tons)
March 26	13,373,000	9,626,000
April 2	11,054,000	9,040,000
April 9	8,255,000	9,420,000
April 16	8,001,000	9,306,000
April 23	7,937,000	9,271,000
April 30	8,424,000	9,125,000
May 7	8,185,000	9,039,000
May 14	8,402,000	9,299,000
May 21	8,273,000	9,282,000
May 28	8,476,000	9,683,000
June 4	7,379,000	8,660,000
June 11	8,524,000	9,624,000
June 18	8,284,000	9,503,000
June 25	8,479,000	9,846,000
July 2	7,981,000	9,490,000
July 9	6,577,000	8,306,000
July 16	8,245,000	10,116,000
July 23	8,259,000	10,150,000
July 30	8,594,000	10,540,000
Aug. 6	8,495,000	10,150,000
Aug. 13	9,093,000	10,628,000
Aug. 20	9,142,000	10,533,000

Anthracite output is showing a seasonal increase, following an unusually dull Summer, and in the week of August 20 was the highest since June, though still considerably under the levels of a year ago. Operators have announced a price advance at the mines of twenty-five cents a ton to take effect September 1.

Oil Production and Prospects

In the past week the Bureau of Mines made public its computation of the production of petroleum in the United States in 1926, and the figures, 770,874,000 barrels, constitute a new record.

Due to the increasing production abroad, particularly in Venezuela, which nearly doubled its output, the United States produced a smaller proportion of the world's oil than in 1925, its percentage declining from 71.5 in 1925 to 70 last year. The total world production is placed by the Bureau at 1,096,000,000 barrels, an increase of 27,000,000 barrels over 1925.

The total value of the crude petroleum produced in this country was $1,447,760,000, and the average price per barrel was $1.88, an increase of 20 cents per barrel over 1925. The prosperity of the industry in 1925 has not been maintained in 1927, owing to excess production, and particularly to expansion in Oklahoma and Texas, where the area of oil-bearing territory was greatly extended.

Notwithstanding the enormous volume of present production and the rapid increase in the demand for petroleum products, Mr. J. C. Welliver, of the American Petroleum Institute, makes the following reassuring comment upon the future of supplies:

Future Supplies Seem Secure

Inevitably, the problem of assuring ample supplies of petroleum over a long future is of keen concern. From the beginning, there have been epochs of anxiety, predictions of shortage. Yet demand gains by leaps and bounds, and supply keeps pace. There have been at times threats of over-production, at others of shortage. But economic factors have always wrought corrections; if there is over-production, prices presently tend downwards and production decreases; if under-production, prices move upward and furnish the urge for an increase of production which restores the balance. Constant discovery of new fields, deeper and ever-deeper drilling, larger recoveries from the oil-bearing sands, more efficient refining, and the cracking of a constantly greater proportion of the heavy oil—all these things have kept supplies in pace with demand. It is now realized that if ever the supply of well oil definitely sags, there is an almost inexhaustible resource at hand, in the oil-bearing shales which are scattered throughout many states, and in the distillation of oil from coal. Scientists, technologists, government initiative, and the industry's interest have united in the research and investigation which seem to assure against a motor-fuel famine.

Money and Banking

Action by eight of the regional Federal Reserve banks in reducing rediscount rates from 4 to 3½ per cent has constituted the leading event in the money market during the past month. Led by the Federal Reserve Bank of Kansas City, which changed its rate late in July, the other banks which have announced reductions are, in the order named, St. Louis, New York, Boston, Cleveland, Dallas, Atlanta, and Richmond. These reductions, supplemented by substantial purchases by the Reserve banks of Government securities in the open market, have been an important factor in a general lowering of money rates during the month.

Call loans, which have averaged quite consistently around 4 per cent most of the time since January, dropped in August to 3¾ and then to 3½ per cent. Time money for 90-day periods declined from 4⅜ to 4 per cent, the lowest since June, 1926.

In the bill market, rates which had begun to soften in July, dropped a further ⅛ to a range of 3¼ bid 3⅛ asked for 90-day maturities, at which levels they were the lowest since May a year ago. Commercial paper was likewise easier, the open market rate on prime names declining to 4 per cent, against 4¼ quoted a month ago.

Downward revisions in rates at this time are in contrast with the tendency a year ago when quotations were moving upward in response to the usual seasonal demands for crop moving and preparations for Fall trade. In view of the large amount of funds now available, the outlook appears to be for a continuation of easy money conditions. While seasonal demands will doubtless find some reflection in the market in September and October, the changes on this account seem likely to be less than usual.

Influence of the Reserve Bank Operations

Reserving discussion of the factors most likely to have influenced Federal Reserve rate policy for succeeding pages, a word may be said here as to the means adopted for putting this policy into effect. To this end both the reduction of rediscount rates and the purchases by the Reserve banks of securities in the open market were equally important.

Inasmuch, however, as attention in the public press has been given over so largely to the rate changes, it is in order to call attention to the part played by the open market purchases. During the past month the Reserve banks increased their holdings of Government securities by approximately $60,000,000, and in making these purchases put an equivalent amount of credit at the disposal of the member banks which the latter could use either to reduce indebtedness at the Reserve banks or offer in the open market in competition with other funds. Largely as a result of these operations, the seasonal demand for funds has thus far been met without increased rediscounting on the part of member banks and money rates, in consequence, have shown the easier tendencies described in foregoing paragraphs.

At the Member Banks

While the operations of the Reserve banks have been a leading influence in money tendencies during the month, various other factors have also contributed to an easy condition of the market.

With factory payrolls throughout the country running somewhat lower than a year ago, currency in circulation is likewise somewhat under 1926 levels, which by lessening member bank dependence upon the Reserve banks for currency, tends to make money easier.

Volume of member bank credit, which up to June was expanding rapidly, has been declining, as represented by the fact that total loans and investments of these banks at the latest reporting date (August 24) were $364,000,000 below the June peak.

Of this decrease, $271,000,000 represented decrease in member bank security investments, due partly to gradual distribution of Treasury securities subscribed for June 15 and partly to sale of other investments.

Brokers' loans, after a temporary decline during June and July, recovered during the past month to a new peak of $3,190,000,000 on August 10, from which there has since been a moderate reaction. Due, however, to decreases in other collateral loans, total loans secured by stocks and bonds have gone off and on August 24 were $104,000,000 under the high point at the end of June.

Unsecured loans, generally taken to reflect commercial borrowing, have increased in recent weeks in accordance with the seasonal tendency and are $191,000,000, or 2.2 per cent higher than a year ago. Owing to the existence of the other factors making for ease, these advances have been without effect on money rates.

The Bond Market

The buying of bonds by investors, which has been steadily on the increase since the price declines of last month, was given new impetus by the prevalence of easy money and the reduction of Federal Reserve rediscount rates to a 3½% level. Such action by banks in the Federal Reserve system emphasized the story which the bond market has been telling fairly consistently since the first of the year—that there is a plethora of funds still available for investment. In the light of events during the past thirty days the June-July reaction appears more clearly than ever to have been simply a technical correction of an overbought situation. To have received a setback of almost a point in the averages and then to have recovered to new high levels is somewhat of an accomplishment during the summer season when buying lassitude ordinarily prevails.

The last week of August again found the averages in new high territory. The Dow-Jones figure for forty listed domestic corporate issues (10 high grade rails, 10 second grade rails, 10 industrials and 10 public utilities) reached a high of 98.02, as compared with 97.06 on July 25th and 94.92 on August 25th a year ago. This recovery was largely due to the restricted volume of new offerings

and lowering money rates. The market is now apparently in condition to absorb easily any seasonal increase in the volume of new offerings during the Fall.

United States Governments

Present indications that a major part of United States Treasury refunding requirements for the balance of 1927, possibly even including about $1,200,000,000 of Second Liberties called for payment on November 15th, will be taken care of through the issuance of shorter term notes, is having a stimulating effect upon the market for longer term Government securities generally. Several issues reached new high levels. Both the 3½ per cent Treasury Notes of 1932-30 and long term 3⅜ per cent Treasury bonds of 1947-43, offered in exchange for Liberty 2nd 4¼s of March 15th and June 15th of this year respectively, are selling in the open market at the present time at a slight premium over their original subscription prices.

Municipals on the Up-Grade

The substantial improvement in the general bond market during the month is being reflected in a renewed interest in municipals. Although transactions are still at a relatively quiet pace, a firmer undertone now prevails. Estimates as to the volume of bonds still in the hands of dealers are quite diverse but there is substantial agreement that such holdings are now within easily manageable limits and that the promised seasonal increase in investment buying will easily take care of any increase in new offerings this fall. Should easy money continue and the flow of new securities remain near its present level, it is reasonable to expect firmer municipal prices. The most important offering during the month was a $15,000,000 issue of City of Philadelphia Bonds. These were divided—$6,750,000 of 15-year 4s offered to yield 4.04 per cent, and $8,250,000 of 50-20 year 4¼s offered to yield 4.09 per cent. Both blocks met a ready sale.

Something of a novelty in municipal finance appears in an advertisement of the City of Jacksonville, Florida, offering for sale $610,000 of "Aeroplane Landing Field" bonds. This is the first time so far as known that the ultra-modern requirements of aviation have been met through issuance of public obligations.

Stock Financing Reflects Improvement in Rails

An announcement by the Canadian Pacific Railroad of an offering of $32,500,000 of new ordinary stock to be sold to present shareholders at $150 a share, and $5,000,000 more to be sold to officers and employes, places this road seventh in the list of North American carriers to finance through stock issues so far this year. Other railroads which have completed or prepared for stock sales since January 1st include the Saint Louis—San Francisco, $15,096,200; the Baltimore and Ohio, $63,242,500; the Old Colony, $891,700; the New York Central, $38,325,000; Bangor and Aroostook, $1,468,000; and the New Haven proposing about $49,000,000 of preferred stock. The ability of many railroads to finance a substantial portion of their new capital requirements through stocks rather than bonds, arises from the remarkable improvement in the earnings position of these lines during recent years. It was not long ago that the credit of the rails was seriously impaired by the war aftermath and an offering of common stocks would have received little public response. The continued emission of bonds during that period brought about an unbalance in capital structure which is now in the way of being corrected. The Interstate Commerce Commission is now favorable toward granting approval for stock issues wherever the credit of the road is such as to insure a ready sale. This continued flow of funds into direct rail ownership will increase equities back of outstanding bonds and thus should gradually improve their investment position.

Both high grade and second grade railroad bonds were in good demand during the month and several price records were established. The new issue of Chesapeake Corporation 5s reached a new high of 99 indicating that they have been thoroughly absorbed despite the fact that they were brought out at a time when the market had developed signs of indigestion. The Baltimore and Ohio First 4s, Canadian Pacific Debenture 4s, and Cuba Railroad 5s, all made substantial gains. Erie Convertibles were again active on the up side in sympathy with the strength of Erie stocks.

The sale of $40,000,000 Chicago, Rock Island and Pacific Railway Company Twenty-five-Year Secured 4½% Gold Bonds on a 4.85% basis took place during the month. It is one of the largest pieces of new railroad financing this year. The basis on which these Bonds were promptly sold to investors is further proof of the improvement in railroad credit. Since its reorganization in 1917, the Rock Island has paid dividends on its 6% and 7% Preferred Stocks, and this year, it began payment of Common Stock dividends. The sale of these Bonds is the first step in a comprehensive refunding program which the Company has undertaken, looking to the maturity of its First and Refunding 4% Bonds, which are due April 1, 1934.

The Foreign Field

The Commonwealth of Australia came into this market in the latter part of the month with an issue of $40,000,000 of 5 per cent thirty-year bonds, redeemable at the option of the Commonwealth as a whole or in part at

102 on or after September 1, 1947, or at 100 on or after September 1, 1952, offered at 98. This loan is issued by the Commonwealth of Australia as a central borrower on behalf of itself and the States of Australia. In the past the several States have borrowed separately, each in its own behalf, and in connection with this offering the following official statement is made about the new policy which contemplates that the Commonwealth will assume the debts of the States, and do the future borrowing for all:

At a recent conference of Premiers, an Agreement was entered into for adjusting the financial relationships between the Commonwealth and the States of Australia. This Agreement will operate for two years, before the end of which period the people will be asked by referendum to embody the terms of the Agreement permanently in the Federal Constitution. The Agreement contemplates that the Commonwealth shall take over the debts of the States, the Commonwealth to apply for a period of fifty-eight years from July 1, 1927, towards the interest on those debts, a sum equal to the total of the per capita payments made by the Commonwealth to the States in the year ended June 30, 1927 and the States to provide the balance of the interest. There is a further provision that the Commonwealth and the States, out of their respective revenues, shall make annual contributions to a Sinking Fund, designed to extinguish the present debts of the States in a period of between fifty and sixty years from the present time and all future loans within a similar period from the time of their issuance. All future borrowing for the purposes of the Commonwealth and the States is to be arranged by the Commonwealth, in accordance with decisions of the Loan Council, which is representative of the Commonwealth and of the States. In respect of such borrowing, Commonwealth securities are to be issued, except where the Loan Council unanimously decides that the securities of a State may be issued, in which case the State securities so issued are to be guaranteed by the Commonwealth.

The proceeds of the loan will be used for developmental and productive public works and for the payment of maturing debt.

Another large offering was a $40,000,000 issue of the Argentine national government, for the purpose of funding the floating debt of the government-owned railroads. The bonds bear 6 per cent and were priced at 99½.

Of the outstanding foreign issues, French Government issues were all strong, the French 8s reaching a new high record of 112 and the 7½s touching 114¼. Belgian issues were active, the 7½s making a new high of 114¾. German Republic 7s reached 107¼, a new high on the recovery, and Berlin 6½s, German Central Agricultural Bank 6s and other German issues showed a strong upward trend. Italian Governments and municipals were also buoyant, the Government 7s reaching the best level in the present advance and the Milan 6½s showing substantial gains. South American issues generally were quiet but firm. Broader knowledge of the foreign investment field and increasing confidence in the ability of responsible foreign borrowers to meet their loan contracts are both apparently substantial contributing factors to the improvement of prices in the foreign list.

Among the principal new issues, both foreign and domestic, offered during the month were the following:

$ 7,500,000	Consolidated Water Power & Paper Co. 1st "A" 5½s, due Aug. 1, 1947, price 97 and interest, to yield 5.75%.
12,000,000	National Radiator Corp. S. F. Deb. 6½s, due Aug. 1, 1947, price 100 and interest.
15,000,000	City of Philadelphia 4% and 4¼% Bonds, $6,750,000, 4s due Aug. 1, 1942, offered at 99¾ and interest, and $8,250,000, 4¼s due Aug. 1, 1977, offered at 102¼ and interest.
15,000,000	Rhine-Westphalia Electric Power Corp. Direct Mtge. 6s, due May 1, 1952, price 95½ and interest, to yield 6.36%.
20,000,000	Sinclair Consolidated Oil Corp. 3 yr. 1st Lien Coll. "D" 6s, due Sept. 1, 1930, price 99 and interest.
8,460,000	Illinois Central R. R. Co. Equipt. Trust 4½s, Series "O," due $564,000 each July 1 from 1928 to 1942, inc., offered at prices to yield 4.20% to 4.40%, according to maturity.
40,000,000	Commonwealth of Australia 30 yr. Ext. 5s, due Sept. 1, 1957, price 98 and interest, to yield 5⅛%.
40,000,000	Chicago, Rock Island & Pacific Ry. Sec. "A" 4½s, due Sept. 1, 1952, price 95 and interest, to yield about 4.85%.
13,000,000	Columbus (O.) Railway, Power & Light Co. 1st & Ref. "A" 4½s, due July 1, 1957, price 93¾ and interest, to yield about 4.90%.
17,000,000	New England Gas & Electric Association Conv. Deb. 5s, due Sept. 1, 1947, price 99 and interest, to yield 5.08%.
30,942,000	Boston & Maine R. R. 1st Mtge. Series "AC" 5s, due Sept. 1, 1967, price 93¼ and interest, to yield 5.41%.
40,000,000	Government of the Argentine Nation Ext. S. F. 6s, State Railway Bonds of 1927, due Sept. 1, 1960, price 99½ and interest, to yield over 6%.

Argentina Resumes Gold Payments

Announcement by the Argentine Government of the resumption of gold payments by the Conversion Office on August 27, marks the return of another country to the free gold standard. Gold payments were suspended at the outbreak of the war, and the exchange rates have fluctuated widely in the meantime, with the varying state of trade. When payments were suspended the Office held 194,452,000 gold pesos, and inasmuch as it has continued to receive gold in exchange for the paper currency while declining to pay gold, its holdings of the metal have been increased until at the re-opening they are given as 455,663,784 gold pesos or approximately $440,000,000. Proposals for the resumption of gold payments have been under consideration for some time, but the favorable trade balance created by the last bountiful crop is responsible for the decision. Approximately $20,000,000 in gold has been taken from South Africa and London in the last two weeks for Buenos Aires, moving in response to exchange rates. In the past thirteen years whatever gold went into the Conversion Office was practically interned and withdrawn from the influence of exchange rates, while hereafter the Argentine stock will perform its normal function in regulating the exchanges. It signifies another step in the restoration of pre-war conditions.

International Money Markets

The reduction of Federal Reserve discount rates last month was welcomed generally in Europe, as lessening the probability of gold exports to this country during the Fall months, the season when exchange rates are most favorable to such a movement. It is evident that the financial centers over there are more or less apprehensive that the large balances accruing to the United States in world trade and on interest account may prove to be an increasing menace to their gold reserves. They do not know in just what manner financial relations with the United States will ultimately find adjustment, and they apprehend that in the absence of other means of settlement they may continue to lose gold.

Paris has been flooded with tenders of gold and foreign currencies this year, hence is not one of the centers immediately concerned. The French situation, however, has been exceptional, because of the pronounced improvement in the financial status of the Government and consequent reaction from a state of great stringency and depression. Belgium also, as a result of the monetary reform of last October, has been recovering capital which had left the country during the period of currency depreciation, and the national bank has reduced its discount rate by stages, ½ per cent each time, from 7 per cent in October to 5 per cent in June, 1927. Elsewhere in Europe conditions have been more or less stringent. The Reichsbank's rate was raised from 5 to 6 per cent in June and that of the Austrian National Bank from 6 to 7 in July, but the latter has been since reduced to 6½. The Bank of the Netherlands, which for several years has shared with the Swiss National Bank the distinction of having the lowest bank rate in Europe (3½) holds so strong a position that it has maintained the rate, which applies only to acceptances, but the trend of exchange transactions is shown by the fact that the Bank has parted with about $15,000,000 of gold in the last three months and a larger amount of foreign bills. The gold came to the United States.

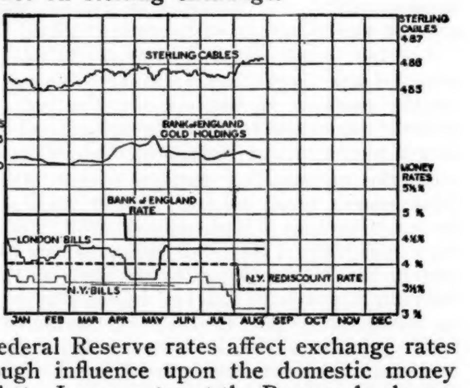
The crux of the situation has been at London, the most important clearing center and where the supply of new gold, largely from the South African mines, meets the world demand. Last April the Bank of England, on the strength of better trade conditions and a gain of about $10,000,000 in its gold stock from the first of the year, reduced its discount rate from 5 to 4½ per cent. This action was very pleasing to the business community, which ventured to hope that a further reduction to 4 per cent might soon follow. Subsequent developments, however, have shown that London's position in the exchanges was not strong enough to justify a 4 per cent rate, and it is probable that if later developments could have been foreseen the reduction to 4½ would not have been made. The uncertainty occasioned by heavy purchases of French exchange was not anticipated, and the improvement in British foreign trade has not been sufficient to materially help the exchange situation. The Bank not only has failed to increase its gold holdings but has lost nearly all of the year's gains made prior to the rate reduction. Looking forward to the season of heavy imports from the United States it seemed probable in July that the Bank rate would have to go back to 5 per cent and that even this alone might not prevent a movement of gold to this country.

A recent development of importance has been a heavy movement of gold to Argentina from South Africa and London, occasioned by large grain shipments from the former country. The aggregate of these shipments is reported at approximately $20,000,000 and practically all may be considered as drafts on London.

The Federal Reserve Reduction

The Federal Reserve reduction has had the effect of slightly strengthening foreign currencies in the exchanges, sterling moving up ½ to ⅝ of a cent, which gives it a position above $4.86 and with a safe margin above the outward gold point.

The accompanying diagram illustrates graphically the recent movement of money rates in the New York and London markets, changes in gold holdings of the Bank of England as described in foregoing paragraphs, and the effect of the bank rate reduction in this market on sterling exchange.



Federal Reserve rates affect exchange rates through influence upon the domestic money market. Lower rates at the Reserve banks are a bearish influence upon money; they place money at the disposal of member banks at lower cost, and whether the facilities are used to any great extent or not the offering has a sentimental effect. A lower level of interest rates in this country tends to cause a movement of loanable funds to other markets, or discourage transfers to this market.

It is well to distinguish between the so-called transfer of funds by means of exchange

operations and actual transfer by the shipment of gold. The newspapers in referring to the rise of sterling have said that American bankers were transferring funds to London for employment. Current discount rates are higher in London than here, and doubtless American bankers have bought sterling exchange to some extent, which means an exchange of funds in New York for funds in London; but while this serves their purpose it is evident that such transactions do not in reality move any funds from New York or increase the amount of funds in London. What they do is relieve the downward pressure on sterling exchange by increasing the number of buyers and affording a means of getting funds out of London without reducing the amount there. The supply of loanable funds in London depends upon the Bank of England's gold reserve: the reserve has not been increased by the advance of sterling exchange, but the danger of a loss has been diminished, making it unnecessary for London to raise the Bank rate to avert withdrawals.

It is doubtful if much business has been done at the higher exchange rate, as the advance itself tends to check the conversion of New York funds. It is quite likely, however, that the lower discount rates in this country will have the effect of causing the Fall exports of grain and cotton to be financed more largely in this country, thus reducing the demands on London. Before the war practically all export and import business was financed abroad, by reason of the lower rates prevailing there. At present, rates on corresponding classes of paper are at least 1 per cent lower in New York than in London.

Capital Demands on the United States

A situation in which tight money and high interest rates abroad are offset against easy money and low interest rates in this country inevitably tends to increase the demands upon this market for loans of all kinds. The tight situation in the London market is unfavorable to capital flotations there. In some quarters the opinion prevails that the unofficial embargo upon foreign loans which was maintained for some time prior to and following the resumption of gold payments should not have been lifted, on the ground that such loans tend to reduce the Bank's reserve and compel it to maintain a high discount rate, to the disadvantage of the business community. On the other hand foreign loans always have been counted an important factor in bringing orders to British industries, and it was largely upon this theory that the embargo was lifted. Such loans in the first seven months of this year aggregated nearly $400,000,000, and the opposition holds them in part responsible for the present situation. If this be so the situation has worked is own cure, for in July a Commonwealth of Australia loan for £7,000,000 was left on the hands of the underwriters to the extent of 90 per cent. Since then the Commonwealth has come into the New York market with a loan of $40,000,000. So long as London is under strain it will be unable to lend freely, and unless the United States responds to demands the needs of the borrowing countries will not be supplied. Inasmuch as the industrial progress of the world is financed to a great extent in this manner, and employment and trade in all countries are largely dependent upon the continual flow and investment of new capital, it is important that new supplies shall be provided somewhere.

The ultimate market for long-term loans is with private investors, savings institutions and other corporations which buy for permanent holdings, but the aid of the regular banking institutions is enlisted in carrying such issues in the process of distribution, hence the state of the short-term money market is an important factor in flotations. Moreover, banks of the commercial class are accustomed to carry more or less investment securities and to increase their holdings in the absence of other means of employing their lending power—a situation which has existed in the United States since 1922. Thus conditions in the short-term money market exert an influence in the long-term market.

Extent of Central Bank Control

The present situation naturally raises the question as to how much central banks can do in the exercise of control over interest rates, exchange rates, and international credit relations. Their direct influence is upon the supply of bank credit and they are primarily interested in financing the turnover of trade, but their operations necessarily affect the supply of bank funds for all purposes. In most countries, however, the amount of central bank credit employed is a small part of the total amount of bank credit in use and a small figure in comparison with the volume of either domestic or foreign trade. The institutions are dealing with aggregates very much larger than their own and it follows that while they are able to exert a wholesome influence over fluctuations, they must conform their policies to fundamental economic conditions.

In the long run money markets and exchanges are controlled by the state of industry and trade, and while banking policies are a factor in these, the banks are not on an independent footing, but are themselves dependent upon them. The industries of Great Britain have not regained their old position in world trade since the war, and last year's coal strike played havoc with British exports and the working capital of many British companies,

forcing the latter to increased employment of bank funds.

The Board of Trade, a government office, has estimated the country's net favorable balance in foreign accounts of all kinds at £181,000,000 in 1913 and £153,000,000 in 1923, while for 1926 it reports a net debit balance of £12,000,000. Obviously this loss of income has an effect upon the position of London in the exchanges which is beyond the power of the British banks to wholly overcome. The business public has wanted cheaper money from the banks at the same time it was wanting larger accommodations, and the banks have been under the necessity of keeping rates high enough to hold foreign funds in London and prevent the loss of gold. Of course, there has been criticism of the banks; the "money power" has been accused of dominating industry, and the usual proposals, such as cutting loose from the gold standard, having the Government issue "sufficient" supplies of money, etc., have been offered.

At the annual dinner of the Lord Mayor of London to the Governor and Directors of the Bank of England and others, held July 12, Mr. Cecil Lubbock, Deputy Governor of the Bank, responding on behalf of the Governor, said:

What we want (they seem to say), what we want from the City of London is money, cheap money and plenty of it, and if those who now have the direction of our financial affairs cannot or will not give it to us, we must look about and find others who can.

Well, the broad and easy road lies, as it has always lain, very near, the broad primrose path which looks so inviting even though the primroses are only made of paper. But we have seen others go over the precipice which is not far down the road and we have learned to be cautious. On the other hand lies the old, hard, uphill road where there are two hard things without which we shall make no progress—hard work and hard money—and we may be sure that we shall not make the necessity for hard work any the less by playing tricks with our money. Increased bank credits, enlarged currency issues may be all very well at the right time and on the right occasion, but they will never make up for the loss, say, of 50 million tons of coal and the vast impoverishment that that loss has brought with it.

Reserve Bank Policy

The London Times of August 8 on its financial page, commented upon the London situation and the reduction of the Federal Reserve discount rate as we quote below. The "advances" referred to are accommodations to customers on their general credit, as distinguished from bills of exchange representing specific transactions, which constitute the highest form of credit in that market.

In this country a rise in Bank rate in the immediate future has fortunately been avoided by the reduction in the American rate, but this is due to the comfortable credit position of America, with her great stocks of gold, and is not due to any favourable movement in the British credit situation, which remains as tight as a drum. The advances of the ten London clearing banks amount to £934,556,000, equal to 54.4 per cent. of the deposits; this is an increase of nearly £200,000,000 in five years; but unfortunately in the same period our reserves have not increased, as they have done in America. Any review, therefore, of the monetary situation cannot ignore the broadmindedness which has distinguished the recent policy of the Federal Reserve Banks.

Other comments, while indicating that the situation has been temporarily relieved, reflect the view which has been frequently expressed on the other side that the international situation is fundamentally unbalanced by the heavy payments running to the United States and that some more radical change of policy on the part of this country is needed.

The general tenor of these opinions is that the continued accumulation of gold in the United States is preventing other countries from obtaining the additional reserves which they need in order to provide for the expansion of credit, and that this has the effect of restricting business and forcing a decline of prices.

Current news dispatches say that Mr. Philip Snowden, former Chancellor of the Exchequer, has written a letter to a London financial paper upon this subject, urging as a means of averting the danger of a prolonged decline of prices, "the formation of some plan with the essential co-operation of the United States for controlling the world's gold stocks and stabilization of prices."

He is quoted as saying that "America doubtless will in time realize that her own interests coincide with those of the world. In that case her surplus gold reserves may be made available."

The policy of the Federal Reserve authorities, even since the recent rate reduction, is commented upon in various quarters as having been generally directed with the design of lowering the price level and of promoting gold importations, or at least retaining present gold holdings. Thus the London "Statist" of August 13, discussing the trend of prices says that "the evident inadequacy of the gold supply, the natural tendency of central banking authorities to err on the side of caution, and the anxiety of the United States Federal Reserve Board to check any pronounced rise in the price level, all point towards further deflation."

The Midland Bank of London, in its latest issue discusses the subject at length and in a spirit of great fairness presents both sides of the United States situation. For lack of space we quote but briefly. It says:

The return of various European countries, not excepting Great Britain, to the gold basis would have been materially facilitated had the United States decided to stabilise her price level at a higher figure. To that extent her policy in allowing prices to fall so far and in refusing to permit any marked upward movement to take place has retarded general world recovery and therefore indirectly injured her own interests. Any further continuous decline in dollar prices would enhance the difficulties already cumbering the road to full economic productivity and the free exchange of goods.

Closing its discussion of Federal Reserve policy, it says:

Finally, it is impossible to avoid the conclusion that but for skilful management the enormous influx

of gold into the United States since the war would have led to the attainment and perpetuation of a price level at least a good deal higher than at present. It needed policy translated into practice to neutralise the full effect of the inflowing gold. From these facts it is clear that the Federal Reserve authorities have directed their efforts to maintaining the price level on a fairly even keel, at the same time providing a full supply of credit to meet legitimate business requirements. Considering the difficulties of the situation, they have met with a great measure of success.

"The Nation," a London weekly journal, commenting upon the rate reduction, says:

Hitherto the Federal Reserve Bank authorities have kept credit conditions so tight, despite their superabundant reserves of gold, that commodity prices have fallen considerably during the last few years. They have in effect pursued a deflationary policy; and they have done this because of the prevailing buoyant tendencies of the stock markets, in which they have detected signs of danger. We may say, with essential accuracy, that they have been trying to stabilize the price-level, but that they have included in the price-level as an integral ingredient, the prices of stocks and shares; and, as stock prices have been rising, commodity prices have had to fall. This policy is open to criticism on purely domestic grounds; the rise in the prices of stocks reflects a genuine increase in American productivity, and does not seem to have gone further than is fully justified by this consideration. For Europe and Great Britain in particular, the pursuit of this policy has been a serious misfortune. By returning to the gold standard we imposed on ourselves the awkward necessity of adjusting our price-level to the lower level of gold prices, and we have found that this lower level has tended constantly to fall, thus making the task more difficult. Nothing accordingly could be more welcome than the assurance, if we can entertain it, that the deflationary tendency will no longer continue.

Professor Gustav Cassel, of the University of Sweden in an article in the July number of the Quarterly issued by the Skandinaviska Kreditaktiebolaget, one of the leading banks of Sweden, again presents his well known views upon the outlook for declining gold production and the effect it may be expected to have upon the price level unless banking policies are adapted to it, incidentally referring to the gold accumulations of the United States and India. He says, in part:

At one time it seemed as though the United States were by no means unwilling to part with their gold. But now there seems to be a tendency in the reverse direction, and the United States are again manifesting a keen desire to accumulate gold.

It is becoming increasingly evident that this fall of prices is connected with an increasing demand for gold for monetary purposes. Since the latter half of 1925 there has been a tendency for gold to flow back to the United States, and in 1926 the net import of gold amounted to the rather considerable sum of 99 million dollars. In January, 1927, the import was no less than 47 million dollars. This import of gold is, of course, ultimately an indication that the United States are anxious to obtain gold covering for their currency. The same is, obviously, the case with several other countries, which are endeavouring to accumulate gold in the belief that it is necessary in order to secure a more solid basis for their monetary system. If this situation is allowed to develop into a general scramble for gold, the shortage of gold must inevitably become very serious, and under such conditions it will be impossible to prevent a successive lowering of the level of prices.

Professor Cassel seems to be impressed that the banking authorities of the United States have been favorable to the acquisition of gold, but there is no evidence for that conclusion except the fact that gold has continued to come. It is of course possible to argue that imports might not have come if banking policies had been different, but certainly there is evidence that Federal Reserve policies have been designed to discourage rather than encourage them. Gold moves in response to various influences and usually as the result of a combination of circumstances. The reasons for the movement of gold from Europe to the United States this year will have to be sought outside of this country. It has not been due to higher interest rates in this country, and it is well known that the Reserve authorities prevented the importation of $60,000,000 from London, by purchase and subsequent disposition elsewhere.

The Decline of Prices

It is late to discuss the decline of prices which occurred in 1920-22, but banking policy was not responsible for it, except as efforts to put limits upon a dangerous expansion of credit may have been related to it. Probably the above references to a deflationary policy relate to the more recent tendency of the price level. There is no reason for thinking that it has been due to restriction of credit in this country, for credit has been abundant and rarely so cheap. Federal reserve discount rates have been below all corresponding rates in Europe. They have not been above 4 per cent since early 1924, and in that time have been as low as 3 per cent. Enterprise and industry have not been restricted. Moreover, an enormous increase in the volume of outstanding bank credit has occurred. From March 20, 1922, to March 22, 1927, the loans, discounts and investments of the member banks of the Reserve system increased from $23,403,000,000 to $32,136,000,000, or by approximately 38 per cent in five years.

This has been much more than enough credit to meet the requirements of an increasing volume of industry and trade; the greater part of it has gone to the stock market, into real estate operations or elsewhere outside of industry, and has done so because industry was amply supplied and wanted no more. While there is a basis for the contention that the high price of credit in Europe delays recovery there and thus exerts an unfavorable influence upon world prices, there is no evidence of downward pressure upon commodity prices in this country, except as results from increasing productivity and efficiency in the industries and in some instances from increasing foreign competition. The price level of the United States is not below the price levels of Europe.

The Inflation Remedy

It is true that the volume of Reserve bank credit in use has not increased since 1922, and this seems to be the crux of the foreign comments. It was the common expectation abroad that the movement of gold to the United

States would be promptly followed by a period of inflation, with the result that the trade balance would be reversed and gold would flow out. This expectation of course was in accord with the orthodox theory of gold distribution in normal times, and in reliance upon it the opinion was advanced in some quarters that before attempting to return to the gold basis Europe should deliberately deluge America with gold until the reaction occurred.

It is difficult to wholly distinguish the current theories of what American banking policy should be from the earlier theorizing. Is it the idea that Federal Reserve discount rates should be lowered enough to overcome all hesitation and caution on the part of member banks and the borrowing public and force a period of inflation in this country which will eventually result in the expulsion of gold? In view of the present state of credit expansion this suggestion seems like a proposal for the American business community to deliberately repeat the experience which ended so disastrously in 1920-22.

A great expansion of credit has occurred since that period in some lines, but industry and trade have participated but slightly, perhaps because commodity prices ever since the decline have been much above the pre-war level. At any rate, the psychology throughout industry and trade has been against commodity speculation.

The World Equilibrium

We are not questioning the importance of the world equilibrium, which undoubtedly has been disturbed by the events of the last twelve years. The needs of Europe for current credit cannot be adequately supplied from the United States and if the balance of payments running to this country actually threatens to prevent Europe from acquiring a normal increase of banking reserves, the situation is serious and not at all to the advantage of this country. It may be doubted that such is the case, and, any way, inflation does not appear to be a necessary remedy. The international accounts are not fixed and unchanging but have numerous items which are changing constantly, either under the influence of governmental policies or the natural influence of economic conditions. Arguments in regard to governmental policies on the tariff and foreign debt settlements have been urged on this account, but it has not been made clear that the balance of payments needs to be taken into account in dealing with these subjects. Thus far, the opinion has prevailed that our international transactions are of such magnitude and variety that they will adapt themselves to conditions, and that the equilibrium will be maintained by the play of natural economic forces.

It may be that this view is erroneous, but as yet it has not been conclusively disproved. There is so much obscurity about the international accounts, and so many difficulties are encountered in attempting to make up a statement of them, that opinions may easily differ over the calculations. The most comprehensive discussion of this subject is that of the Department of Commerce for the year 1926, and previous years, which is graphically presented on the opposite page. It shows a small balance of payments in favor of the United States on current account, and a rather surprising result in the field of investments.

It is to be considered that international trade relations have been violently disturbed in recent years and have not yet settled down to a normal state. Currencies have been passing through inflation, deflation and periods of uncertainty, and wage and price readjustments have been a fruitful source of controversy and trade disorders. We have seen that according to the British Board of Trade there is a difference of approximately $800,000,000 between the results of 1923 and 1926 in Great Britain's business relations of all kinds with the rest of the world. In one of these years there was a net income of approximately $750,000,000 and in the other an adverse balance of approximately $60,000,000. In view of the exceptionally difficult conditions in which that country was involved last year, surely it is not to be assumed that Great Britain is going to be permanently embarrassed about the balance of payments. There is much evidence tending to show that production is increasing throughout Europe, and, as the Deputy Governor of the Bank of England has indicated in a quotation given above, production and ability to trade afford the fundamental basis of every country's position in the exchanges. The loans which the United States has been making in Europe may be assumed to be an important factor in restoring the equilibrium. Time also is a necessary factor. Finally, it may be said that the compilation which has been made by the Department of Commerce does not indicate that there is anything really critical in the relations between the United States and the rest of the world.

Department of Commerce Balance Sheet

The chart at the foot of the opposite page summarizing the total payments under the principal headings, to and from the United States in its business relations of all kinds with the rest of the world in the calendar years 1922 to 1926, has been prepared to represent the tables compiled by the Finance and Investment Division of the Department of Commerce. Owing to limited space the classification has been consolidated to some extent.

The chart in condensing the table gives the excess of credits or debits in each class. Thus the $448,000,000 of net merchandise and silver

exports also includes various services both ways. The $688,000,000 interest on foreign investment is excess above interest running from us to foreigners, and includes interest payments to the United States Government. These two principal items in our credits aggregate $1,136,000,000, while the two principal items in our debit, (aside from capital items) are tourist expenditures and remittances of immigrants, etc., which aggregate $979,000,000. Our net tourist expenditures fall $42,000,000 short of absorbing our net interest receipts.

The chart, by reason of condensation, fails to show many interesting details which appear in the table, but the outstanding fact is that the situation is dominated by investment transactions. Net American investments abroad in 1926 aggregated $1,332,000,000, of which $1,002,000,000 were in public bond issues and $330,000,000 in other forms. On the other hand, payments to us upon the principal of previous foreign loans aggregated $505,000,000 and the net result of American and foreign trading in older issues of American and foreign securities was an increase of $298,000,000 in the holdings by foreigners. It is instructive to note that the aggregate of this trading was over $1,700,000,000. The final result of all new investments and trading was an increase of American investments abroad in excess of foreign investments in this country of about $557,000,000, and a net increase of foreign deposits in American banks, plus short term money market investments, over similar items on the other side amounting to $359,000,000. If our liability on account of the increase in this last item be offset against our gain in the security account it will be seen that the change in our creditor position was comparatively small.

Perhaps the most extraordinary showing of the report is that at the close of the year 1926 foreign deposits in American banks aggregated $1,443,000,000 and that foreigners had on deposit with American agents and trustees American stocks and bonds aggregating about $1,878,000,000—this, of course, in addition to all the American securities physically held abroad.

On account of the dominance of the investment transactions it seems hazardous to make definite predictions as to the balance of payments. It is probable that securities will continue to move in large volume both ways, and that their movements will tend to preserve the equilibrium. The volume of securities in international circulation is such as to negative the probability of any sudden crisis in the settlements.

Any change in the capital items on either side probably would affect the counter items on the other side, but it is evident that our newly made foreign investments are an important factor in the maintenance of our commodity exports and in the collection of interest on our foreign security holdings. It may be noted that our foreign trade balance for the calendar year 1926, which figures in this calculation at $377,000,000, is up to $716,000,000 for the fiscal year ended June 30, 1927.

Net cash payments in gold and currency are small in comparison with even the fluctuations of the principal items, and one is impressed they need not upset the world.

International Balance of Payments of the United States
(As Computed by the Department of Commerce—000,000 omitted)